KEEGAN, WERLIN & PABIAN, LLP

ATTORNEYS AT LAW
265 FRANKLIN STREET
BOSTON, MASSACHUSETTS 02110-3113

(617) 951-1400

TELECOPIERS:
(617) 951-1354
(617) 951-0586

December 21, 2004

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
100 Cambridge Street
Boston, MA 02110

Re: D.T.E. 03-47-B (Phase II) Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company and NSTAR Gas Company, Pension/PBOP Adjustment Compliance Filing

Dear Secretary Cottrell:

Boston Edison Company ("Boston Edison"), Cambridge Electric Light Company ("Cambridge"), Commonwealth Electric Company ("Commonwealth") and NSTAR Gas Company ("NSTAR Gas") (together, the "Company" or "NSTAR") file this reply letter in response to the initial brief of the Attorney General of the Commonwealth (the "Attorney General") in the above-referenced proceeding before the Department of Telecommunications and Energy (the "Department").[1] As discussed in the Company's initial brief, this proceeding relates to the Compliance Filing submitted by the Company to implement the Department's directives in Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company and NSTAR Gas Company, D.T.E. 03-47-A (2003) (the "Order").

In his Initial Brief, the Attorney General argues that the Department should either reject the Company's filing or adopt a number of inappropriate adjustments to the Company's calculations. The Attorney General claims that such action is warranted because: (1) the Company has not submitted sufficient evidence to demonstrate that the Company has objectively applied the tariff approved by the Department; and (2) the Company has not demonstrated that overall rates resulting from the tariffs are just and reasonable (Attorney General Initial Brief at 1). However, neither of these claims is justified or supported by the record.

1 In responding to the Attorney General's Initial Brief, the Company will not repeat arguments at length that were addressed in the Company's Initial Brief. Silence on any matter raised by the Attorney General does not indicate the Company's agreement to any issue raised by the Attorney General. The Company expressly reasserts the positions and arguments set forth in its Initial Brief.

First, it is well-established that the Company's burden in a compliance filing following an approved rate change by the Department is to show: (1) that the tariffs accurately implement the directives of the Department; and (2) that the calculations made to compute the rates are accurate and consistent with the rate tariffs. However, the Company has no burden in a compliance filing to demonstrate that the "overall rates resulting from the tariff adjustment are just and reasonable" (id.). Thus, the Department should firmly reject the Attorney General's argument that the Department should not permit additional pension recoveries under the PAM because the Company has not provided "any evidence" that the "increased" amounts of pension-related expenses recovered from customers result in just and reasonable rates (id. at 4). The Company met this burden through the Department's investigation of the Company's initial petition in this proceeding and, in adopting the PAM, the Department has already determined that its implementation will result in just and reasonable rates, subject to a demonstration that the PAFs are correctly calculated. The Attorney General's argument constitutes nothing more than an untimely motion for reconsideration of the Department's order in D.T.E. 03-47-A.

Second, the Department should reject the Attorney General's multiple claims regarding adjustments to the Company's computations. Specifically, the Attorney General claims: (1) NSTAR has not provided a "fixed formula with objective elements," but rather seeks approval of a formula with "complicated variables that contain a considerable degree of subjectivity in their calculation (id. at 1); (2) the Company has made a "material error" in calculating carrying charges on the average prepaid balance for 2003 (id. at 2); and (3) the 2003 PBOP amount should be reduced by $1.75 million to reflect immediate recognition of cost reductions associated with the Medicare Drug Improvement and Modernization Act of 2003 (id. at 2-3). The Attorney General's arguments are not supported by either the terms of the Department's approval, or the record in this proceeding. Therefore, the Attorney General's claims should be rejected by the Department in their entirety.

For example, the Attorney General's charge that the NSTAR pension formula contains "far too many complicated moving elements" and that NSTAR has not provided a "fixed formula with objective elements" is nothing more than an argument for reconsideration of the Department's decision to approve a PAM for the Company in D.T.E. 03-47-A (2003) (id. at 2). The Attorney General's argument about the complexity of the "formula" is actually a complaint regarding the "complexity" of the assumptions that underlie the calculation of the FAS 87 and FAS 106 expenses. These same issues were raised by the Attorney General during the Department's investigation of the Company's proposal and bear no further consideration in relation to the Compliance Filing. As has been consistently noted throughout this proceeding, the PAM is a reconciling mechanism that will account for differences between actual and projected costs associated with the SFAS 87 and SFAS 106 trust funds.[2] Thus, the Department should reject the Attorney General's continuing attempts to seek reconsideration of the Department's determinations in D.T.E. 03-47-A.

Similarly, the Attorney General contends that the Company has made a "material error" in computing carrying charges on its prepaid pension balance for 2003, including the eight-month period during the rate freeze, because the Department's order denied "a return on the prepaid balance" (id. at 2). This is simply an inaccurate representation of the Department's order in D.T.E. 03-47-A. In D.T.E. 03-47-A, the Department used very precise language to spell out the operation of the PAM. The Department's delineation of the PAM included an unequivocal statement that the Company would be permitted to include carrying costs on the average annual prepaid balance when calculating the Company's PAFs. In relevant part, the Department stated that:

> Carrying costs will be allowed on the average annual prepaid balance expense and the unamortized deferred pension and PBOP expenses, net of deferred taxes.[34]
>
> [34] There will be no carrying costs on the *deferred pension and PBOP expense* recorded by the Companies during the first 8 months of 2003, as discussed in § VI.C.3 of this Order.

Order at 45-46 (emphasis added). Thus, the Department's Order specifically provided for only one exception to the recovery of carrying charges and that was with respect to the carrying charges that are tied to the portion of deferred pension and PBOP expenses that were disallowed for the first eight months of 2003 (Exh. DTE-1-2). The Department's language was clear and precise and followed a detailed discussion on the Company's proposal wherein the distinction between the "average annual prepaid balance" and "deferred pension and PBOP expenses" was starkly drawn.[3] Accordingly, the Company has not made any error whether "material" or otherwise in calculating carrying charges on the average prepaid balance for 2003, including the first eight months of 2003. The Department's Order provided for the full recovery of carrying charges relating to the net prepaid pension balance and the Company appropriately included a carrying charge on the full net prepaid amount for 2003 in accordance with the Department's directives.

---

[2] As stated in the Company's Initial Brief on page 8, "under the pension/PBOP reconciliation mechanism, the Company recovers no more and no less than the amount it contributes to its SFAS 87 and SFAS 106 trust funds and any differences year to year are deferred either in the deferral or the prepaid balances and bear a carrying charge so that neither the Customers nor the Company are adversely affected by the timing differences."

[3] For example, because of the rate freeze, the Department directed the Company to exclude the first eight months of 2003 from the "Reconciliation Adjustment." Order at 33. The Department's Order specifically describes the Reconciliation Adjustment as "pension and PBOP costs being booked by the Companies but not being recovered in base rates, adjusted for any previously unamortized balances." Order at 30. Carrying charges on the prepaid balance are a separate component of the PAM and are not part of the Reconciliation Adjustment. See Order at 33-45.

Lastly, the Attorney General claims that the Company failed to reduce its 2003 PBOP expense amount to reflect the reduction in costs associated with the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the "Act") (Attorney General Brief at 2). Specifically, the Attorney General cites to SFAS 106, ¶ 40 to suggest that the Company overstated its 2003 PBOP cost by $7 million and therefore should have recognized a savings of $1.75 million in 2003 rather than recognizing annual savings attributable to the Act for the first time in 2004 (id. at 3). As with other items discussed in the Attorney General's Initial Brief, the specific guidance provided by the Financial Accounting Standards Board on this topic is misrepresented.[4]

The Company's Compliance Filing in this case was made with the Department on December 1, 2003, *one week before* President Bush signed the Act into law on December 8, 2003. Thus, the Company's Compliance Filing could not have anticipated or reflected the effects of the Act. Moreover, the Company's 2003 PBOP expense amount was determined in April 2003, well before the Act became law. In that regard, although the Attorney General was seemingly careful to quote paragraph 40 of SFAS 106 in his brief, for some reason, he has omitted the last sentence of the paragraph. The omitted sentence states: "Future changes in laws concerning medical costs covered by governmental programs and future changes in the plans of other providers shall **not** be anticipated" (emphasis added). In other words, since the Medicare Act did not even exist at the time of the determination of the Company's 2003 expense amount, the accounting rules prevented its recognition as an adjustment to the 2003 expense. The first FASB guidance concerning how to incorporate the effects of the Act on the measure of a company's PBOP obligations was issued by FASB on January 12, 2004 ("FASB Staff Position 106-1" (see Attachment A, hereto)). According to FASB Staff Position 106-1, PBOP plan sponsors were permitted to defer recognizing the effects of the Act until sufficient guidance could be provided by FASB to ensure that the accounting for the effects of the Act is consistent with generally accepted accounting principles" (see Attachment A, ¶¶ 9-11). Most companies (utilities and companies in general) waited until FASB issued its guidance on this matter in 2004 rather than guessing in 2003 on an accounting judgment that potentially would be inconsistent with the ultimate guidance.

Thus, the Attorney General's assertion that the Company should have "immediately recognized" the effect of the Act in its 2003 PBOP expense amount misrepresents the guidance provided by FASB, which established that specific accounting guidance would be needed from the FASB prior to taking action. In any event, any change resulting from the Act would not be "immediately recognized" as a reduction of expense in 2003, but rather would result in the calculation of an actuarial gain as of December 31, 2003 that would be amortized over future periods. The Company accounted for the change as required by FASB's ultimate guidance (issued in

---

[4] Moreover, the Attorney General's suggestion that there are savings to customers as a result of the reduction in FAS 106 expense fails to explain that these savings would be offset by an increase in the prepaid balance, which is recovered over time with a carrying charge (see footnote 2).

May 2004) to reflect the impact of the Act, retroactively to January 2004. Accordingly, the Department should reject the Attorney General's attempt to "re-write" SFAS 106.

The Company's Compliance Filing accurately and appropriately incorporates all of the Department's directives in D.T.E. 03-47-A, and to the extent applicable, the directives set forth in the Fitchburg Order, D.T.E. 04-48. Therefore, the PAF rates that became effective January 1, 2004 are accurately calculated consistent with the PAM tariffs, and should be allowed to continue in effect. The Attorney General has offered only contrived objections to the Compliance Filing that are more accurately described as untimely motions for reconsideration of the Department's decision in D.T.E. 03-47-A. Accordingly, the Department should approve the Company's Compliance Filing without modification.

Respectfully submitted,

Robert J. Keegan

Attachment

cc: Service list

Attachment A

FASB STAFF POSITION

No. FAS 106-1

Title: Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003

Date Posted: January 12, 2004

1. The Board directed the FASB staff to issue this FASB Staff Position (FSP) which permits a sponsor of a postretirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). Regardless of whether a sponsor elects that deferral, the FSP requires certain disclosures pending further consideration of the underlying accounting issues.

Background

2. On December 8, 2003, the President signed the Act into law. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D.[1] Questions have arisen regarding whether an employer that provides postretirement prescription drug coverage (a plan) should recognize the effects of the Act on its accumulated postretirement benefit obligation (APBO) and net postretirement benefit costs and, if so, when and how to account for those effects.

3. FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, addresses employers' accounting for postretirement health care benefits. Paragraph 40 of Statement 106 states:

> Certain medical claims may be covered by governmental programs under existing law or by other providers of health care benefits.[17] Benefit coverage by those governmental programs shall be assumed to continue as provided by the present law and by other providers pursuant to their present plans. *Presently enacted changes in the law* or amendments of the plans of other health care providers that take effect in future periods and that will affect the future level of their benefit coverage *shall be considered in current-period measurements* for benefits expected to be provided in those future periods. Future changes in laws concerning

[1] This FSP makes reference to various provisions of the Act, and, in many cases, paraphrases those provisions. While those statements reflect the best efforts of the FASB staff to describe relevant aspects of the Act, nothing in this FSP should be considered a definitive interpretation of any provision of the Act for any purpose.

> medical costs covered by governmental programs and future changes in the plans of other providers shall not be anticipated. [Emphasis added.]
>
> [17] For example, a retiree's spouse also may be covered by the spouse's present (or former) employer's health care plan. In that case, the spouse's employer (or former employer) may provide either primary or secondary postretirement health care benefits to the retiree's spouse or dependents.

Medicare existed when Statement 106 was issued, and it is a "governmental program" that should be considered under paragraph 40 in measuring the APBO and net periodic postretirement benefit cost. However, the Act introduces two new features to Medicare that a sponsor needs to consider in determining those measurements: (1) a subsidy to a plan sponsor based on 28 percent of an individual beneficiary's annual prescription drug costs between $250 and $5,000 (subject to indexing and the provisions of the Act as to "allowable retiree costs"),[2] and (2) the opportunity for a retiree to obtain a prescription drug benefit under Medicare.

Federal Subsidy

4. A plan sponsor's eligibility for the 28 percent subsidy depends on whether the plan's prescription drug benefit is at least "actuarially equivalent" to the Medicare Part D benefit. At present, detailed regulations necessary to implement the Act have not been issued, including those that would specify the manner in which actuarial equivalency must be determined and the evidence required to demonstrate actuarial equivalency to the Secretary of Health and Human Services.[3] In addition, the magnitude of the subsidy for a sponsor depends on how many Medicare-eligible retired plan participants choose not to enroll in the *voluntary* Medicare Part D plan. Further, specific regulations regarding the documentation requirements and payment/reimbursement mechanism for the subsidy are yet to be defined by the appropriate administrative agency. Accordingly, questions have been raised regarding whether the subsidy is substantively similar to other Medicare benefits that existed when Statement 106 was issued and, therefore, should be accounted for as a reduction of the APBO and net periodic postretirement benefit cost, or whether the subsidy represents a payment to the sponsor that is determined by reference to the plan's benefit payments but is not, in and of itself, a direct reduction of postretirement benefit costs. Under either view, there is also a question as to when the subsidy should be given accounting recognition.

Effect on Per Capita Claims Cost

5. The effect of the Medicare Part D benefit on a plan that currently provides a prescription drug benefit depends on (a) whether current and future retirees (or their beneficiaries under the employer-sponsored plan) choose to enroll in the voluntary Medicare Part D plan and pay (initially) a $35 monthly premium and (b) the Act's macro socioeconomic effects on health care cost trends and consumers' behavior.

[2] New Section 1860D-22(a) of the Social Security Act created by Section 101 of the Act.

[3] Section 1860D-11(c) of the Social Security Act, as amended by the Act, states that "the Secretary shall establish processes and methods for determining the actuarial valuation of prescription drug coverage."

Other Considerations

6. In addition, the Act excludes the federal subsidy from the taxable income of the plan sponsor for federal income tax purposes.[4] That provision, depending on how the federal subsidy is ultimately viewed for accounting purposes, may affect the temporary difference relating to the APBO that gives rise to a deferred tax asset under FASB Statement No. 109, *Accounting for Income Taxes*.

7. The Act also provides for a two-year transitional period to allow for, among other items, the possibility that plan sponsors may amend existing plans (or establish new ones) in response to the legislation in order to achieve maximum direct financial benefit as well as improve employee relations.[5] To the extent that plan sponsors amend plans (positively or negatively) for employee services already rendered, the APBO will be affected by the direct effects of the change in the benefit formula.

FASB Staff Position

8. Paragraph 40 of Statement 106 requires presently enacted changes in relevant laws to be considered in current period measurements of postretirement benefit costs and the APBO. Therefore, under that guidance, measures of the APBO and net periodic postretirement benefit costs on or after the date of enactment should reflect the effects of the Act.

9. However, (1) certain accounting issues raised by the Act—in particular, how to account for the federal subsidy—are not explicitly addressed by Statement 106 and (2) significant uncertainties may exist for a plan sponsor both as to the direct effects of the Act and its ancillary effects on plan participants' behavior and health care costs. Accordingly, a plan sponsor or its advisors may not have (a) sufficiently reliable information available on which to measure the effects of the Act, (b) sufficient time before issuance of financial statements for fiscal years that include the Act's enactment date to prepare actuarial valuations that reflect the effects of the Act, or (c) sufficient guidance to ensure that the sponsor's accounting for the effects of the Act is consistent with generally accepted accounting principles. Therefore, a plan sponsor may elect to defer recognizing the effects of the Act in the accounting for its plan under Statement 106 and in providing disclosures related to the plan required by FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, until authoritative guidance on the accounting for the federal subsidy is issued, or until certain other events (as indicated in paragraph 12) occur. Regardless of whether a plan sponsor elects that deferral, certain other disclosures are required.

---

[4] New Section 139A of the Internal Revenue Code established by Section 1202 of the Act.

[5] Section 111 of the Act calls for an initial study (due one year after enactment) and a final study (due no later than January 1, 2007) by the Comptroller General on the impact of the Act on plan design and, in particular, calls for the final study to include recommendations on how the various incentives for private plan sponsors in the Act may be improved.

Disclosures

Plan Sponsor that Elects Deferral

10. An entity that sponsors a postretirement health care plan that provides prescription drug benefits and elects the deferral provided by this FSP should disclose in annual or interim financial statements (a) the existence of the Act and the fact that, in accordance with this FSP, any measures of the APBO or net periodic postretirement benefit cost in the financial statements or accompanying notes do not reflect the effects of the Act on the plan and (b) the fact that specific authoritative guidance on the accounting for the federal subsidy is pending and that guidance, when issued, could require the sponsor to change previously reported information.[6] A plan sponsor that elects the deferral is also encouraged to disclose additional information that it believes is appropriate for the reader to understand the Act's possible economic consequences including whether the sponsor would need to amend the plan (regardless of whether the sponsor intends to do so) in order to benefit from the new legislation. In that context, an additional disclosure could be an estimate of the cash flows that the plan sponsor believes it will be entitled to receive under the federal subsidy. If such estimates are provided, the plan sponsor should acknowledge that the issues of how and when the federal subsidy should be accounted for are not yet resolved by the FASB.

Plan Sponsor that Does Not Elect Deferral

11. A plan sponsor that does not elect the deferral provided by this FSP should disclose in annual or interim financial statements (a) the effects, if any, of the Act on the reported measure of the accumulated postretirement benefit obligation; (b) how that effect has been, or will be reflected, in the net postretirement benefit costs of current or subsequent periods; (c) the effects of any changes in estimates of participation rates or per capita claims costs as a result of the Act; and (d) the fact that specific authoritative guidance on the accounting for the federal subsidy is pending and that guidance, when issued, could require the sponsor to change previously reported information.[6] To the extent a plan sponsor's accounting recognizes the effect of the federal subsidy, the sponsor should disclose the basis for concluding that its plan is at least "actuarially equivalent" (as defined in the Act) to Medicare Part D. In addition, if the plan sponsor concludes that some or all of the federal subsidy related to prescription drug costs included in the APBO should be recognized immediately as a component of income from continuing operations, any amount so recognized should be reported as a separate line item on the face of the income statement or statement of activities.[7] For purposes of this requirement, current period amortization of amounts measured but initially deferred as of the date of enactment of the Act does not constitute immediate recognition.

---

[6] When issued, the guidance on accounting for the federal subsidy will include transition guidance, as applicable, for entities that elected to defer accounting for the effects of the Act and those that did not.

[7] The FASB Staff notes that the accounting for the subsidy is explicitly not addressed in this FSP and nothing in this FSP should be construed as either an endorsement or rejection of any particular accounting treatment of the subsidy, pending the issuance of specific authoritative guidance.

Transition and Effective Date

12. The guidance in this FSP is effective for interim or annual financial statements of fiscal years ending after December 7, 2003. The election to defer accounting for the Act is a one-time election that must be made before net periodic postretirement benefit costs for the period that includes the Act's enactment date are first included in reported financial information pursuant to the requirements of Statement 106.[8] If an entity elects deferral, that election may not be changed, and the deferral continues to apply until authoritative guidance on the accounting for the federal subsidy is issued, or until the guidance in the following sentence applies. The election to defer expires if, subsequent to January 31, 2004, but prior to the issuance of additional authoritative guidance, a significant event occurs that ordinarily would call for remeasurement of a plan's assets and obligations—for example, a plan amendment, settlement, or curtailment. Upon the occurrence of such an event, the sponsor should account for that event pursuant to the guidance in Statement 106 and also should reflect in its accounting for the plan its best estimate of the effects of the Act, including the federal subsidy (if applicable based on the terms of the plan and the sponsor's analysis of generally accepted accounting principles) and any effects on participation rates and health care cost estimates.

[8] When those costs are reported depends on the measurement date selected for the plan pursuant to paragraph 72 of Statement 106. For example, if a public company with a December 31 fiscal year-end uses a September 30 measurement date, the net periodic postretirement benefit costs for the period that includes the Act's enactment date would be reported in the first interim period of 2004.